

DEPARTMENT OF STATE REVENUE

04-20150444.LOF

Letter of Findings Number: 04-20150444
Sales/Use Tax
For Tax Years 2012, 2013, and 2014

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Public utility was responsible for the sales tax on several retail transactions for which it did not collect sales tax or valid exemption certificates from its customer. Public utility provided sufficient documentation to support that the proposed assessment should be adjusted and its request of penalty abatement.

ISSUES

I. Sales/Use Tax - Imposition.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-1-27; IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-4-1; IC § 6-2.5-4-5; IC § 6-2.5-8-8; IC § 6-2.5-9-3; IC § 6-8.1-5-1; Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Scopelite v. Indiana Dep't of Local Gov't Fin., 939 N.E.2d 1138 (Ind. Tax Ct. 2010); Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d 480 (Ind. Tax Ct. 2012); Rhoades v. Indiana Dep't of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); USAir, Inc. v. Indiana Dep't of State Revenue, 623 N.E.2d 466 (Ind. Tax Ct. 1993); [45 IAC 2.2-3-4](#); [45 IAC 2.2-3-14](#); [45 IAC 2.2-8-12](#). Taxpayer protests the Department's proposed assessments, claiming that it was not responsible for certain sales tax and use tax.

II. Tax Administration - Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer requests that the Department abate the negligence penalty.

STATEMENT OF FACTS

Taxpayer is a public utility which sells and distributes electricity to local customers in Indiana. The Indiana Department of Revenue ("Department") conducted a sales/use tax audit for 2012, 2013, and 2014 tax years. Both Taxpayer and the Department agreed to utilize a statistical sample method to project the audit results. Pursuant to the audit, the Department determined that Taxpayer did not collect and remit sales tax on various retail transactions, nor did it provide the Department properly executed exemption certificates at the time of the audit. The Department's audit also determined that Taxpayer did not pay sales tax or self assess and remit use tax on certain purchases of tangible personal property, which Taxpayer used for its business. The Department thus imposed additional sales tax, use tax, interest, and penalty for the tax years at issue.

Taxpayer paid the assessment under protest, claiming that several transactions were exempt from the sales tax. It also stated that it was not liable for a portion of use tax because tax was paid on one selected transaction among the sample population. Taxpayer further requested that the penalty be abated. An administrative hearing was held during which Taxpayer's representatives explained the basis of the protest. This Letter of Findings ensues. Additional facts will be provided as necessary.

I. Sales/Use Tax - Imposition.

DISCUSSION

The Department's audit determined that Taxpayer failed to collect either sales tax or properly executed exemption

certificates on various retail transactions. The audit also determined that Taxpayer purchased certain tangible personal property to be used for its business activities but did not pay taxes on the purchases. The audit thus assessed additional sales tax and use tax.

Taxpayer, to the contrary, believes that the Department's assessments were overstated. Taxpayer argued that it was not responsible for collecting sales tax on sales to customers who are qualified for exemption. Taxpayer also claimed that it was not liable for use tax on one transaction which the sales tax was remitted under the Department's direct pay permit program.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012). Thus, the taxpayer is required to provide documentation explaining and supporting its challenge that the Department's assessment is wrong. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012).

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A "[r]etail transaction" is "a transaction of a retail merchant that constitutes selling at retail as described in [IC 6-2.5-4-1](#) [or] . . . in any other section of [IC 6-2.5-4](#)." IC § 6-2.5-1-2(a). Selling at retail occurs when a person "(1) acquires tangible personal property for the purpose of resale; and (2) transfers that property to another person for consideration." IC § 6-2.5-4-1(b). Tangible personal property includes electricity and gas. IC § 6-2.5-1-27(2). "A power subsidiary or a person engaged as a public utility is a retail merchant making a retail transaction when the subsidiary or person furnishes or sells electrical energy . . . to a person for commercial or domestic consumption." IC § 6-2.5-4-5(b). A person who acquires tangible personal property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b). The retail merchant shall collect the tax as agent for the state." *Id.*

Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). "Use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). The use tax is functionally equivalent to the sales tax. See *Rhoades v. Indiana Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002). By complementing the sales tax, the use tax ensures that non-exempt retail transactions (particularly out-of-state retail transactions) that escape sales tax liability are nevertheless taxed. *Rhoades*, 774 N.E.2d at 1048; *USAir, Inc. v. Indiana Dep't of State Revenue*, 623 N.E.2d 466, 468 - 69 (Ind. Tax Ct. 1993). The use tax ensures that, after such goods arrive in Indiana, the retail purchasers of the goods bear their fair share of the tax burden. *Rhoades*, 774 N.E.2d at 1047 - 1050 (explaining that, generally, states impose a use tax to prevent the erosion of the state's tax base when its residents make purchases in other states). To trigger imposition of Indiana's use tax, tangible personal property must (as a threshold matter) be acquired in a retail transaction. IC § 6-2.5-3-2(a); *USAir, Inc.*, 623 N.E.2d at 468. A taxable retail transaction occurs when (1) a party acquires tangible personal property as part of its ordinary business for the purpose of reselling the property; (2) that property is then exchanged between parties for consideration; and (3) the property is used in Indiana. See IC § 6-2.5-1-2; IC § 6-2.5-4-1(b), (c); IC § 6-2.5-3-2(a).

An exemption from the use tax is granted for transactions where the sales tax was paid at the time of purchase pursuant to IC § 6-2.5-3-4 and [45 IAC 2.2-3-4](#). There are other sales tax exemptions also available as outlined in [IC 6-2.5-5](#). Similarly, the exemptions listed in [IC 6-2.5-5](#) also generally apply to transactions which are subject to Indiana use tax. [45 IAC 2.2-3-14](#)(2).

When a purchaser claims the purchase "is exempt from the state gross retail and use taxes, the purchaser may issue an exemption certificate to the seller instead of paying the tax." IC § 6-2.5-8(a). The "seller accepting a proper exemption certificate under [IC § 6-2.5-8-8] has no duty to collect or remit the state gross retail or use tax on that purchase." *Id.* Otherwise, as an agent for the state, the seller "holds those taxes in trust for the state and is personally liable for the payment of those taxes, plus any penalties and interest attributable to those taxes, to the state." IC § 6-2.5-9-3.

A. Imposition of Sales Tax

The Department assessed sales tax on various retail transactions for which Taxpayer did not collect sales tax, nor

did it collect valid exemption certificates from its customers who claimed that their purchases were exempt.

[45 IAC 2.2-8-12](#), in relevant part, provides:

- (b) Retail merchants are required to collect the sales and use tax on each sale which constitutes a retail transaction unless the merchant can establish that the item purchased will be used by the purchaser for an exempt purpose.
- (c) All retail sales of tangible personal property for delivery in the state of Indiana shall be presumed to be subject to sales or use tax until the contrary is established. The burden of proof is on the buyer and also on the seller unless the seller receives an exemption certificate.
- (d) Unless the seller receives a properly completed exemption certificate the merchant must prove that sales tax was collected and remitted to the state or that the purchaser actually used the item for an exempt purpose. It is, therefore, very important to the seller to obtain an exemption certificate in order to avoid the necessity for such proof. The mere filing of a Registered Retail Merchant Certificate number is not sufficient to relieve the seller of the responsibility to collect the sales tax or prove exempt use by the buyer.
- (e) No exemption certificates are required for sales in interstate commerce, however, proper records must be maintained to substantiate such sales.
- (f) An exemption certificate issued by a purchaser shall not be valid unless it is executed in the prescribed and approved form and unless all information requested on such form is completed.
- (g) An exemption certificate or other evidence supporting an exempt sale must be maintained by the seller for at least three (3) years after the due date of the tax return upon which such exempt transaction is reported.
- (h) Exemption certificates may be reproduced provided no change is made in the wording or content.

In this instance, the Department's audit noted that Taxpayer sells tangible personal property, namely electricity, to local customers. Taxpayer thus is a retail merchant and should have collected and remitted the sales tax on its sales. Taxpayer did not do so. Taxpayer also failed to provide the properly executed exemption certificates, which it should have collected from its customers, to the Department's auditor during the audit. The auditor was therefore unable to verify whether certain sales were exempt from the sales tax.

Pursuant to [45 IAC 2.2-8-12\(b\)](#), "Retail merchants are required to collect sales and use tax on each sale which constitutes a retail transaction unless the merchant can establish that the item purchased will be used for an exempt purpose." [45 IAC 2.2-8-12\(d\)](#) also cautions that, "Unless the seller receives a properly completed exemption certificate the merchant must prove that sales tax was collected and remitted to the state or that the purchaser actually used the item for an exempt purpose. It is, therefore, very important for the seller to obtain an exemption certificate in order to avoid the necessity for such proof." In the absence of the properly signed and executed exemption certificates, the Department's audit properly assessed sales tax on the otherwise taxable sales.

There is no question that Taxpayer entered into retail transactions for which - absent an exemption - Taxpayer was required to collect sales tax. Subsequently, during the protest process, Taxpayer offered three (3) additional exemption certificates concerning sales to its customers C1, C2, and C3, claiming that their purchases were exempt from sales tax. Taxpayer thus maintained that the Department's assessments were overstated. Upon review, the Department is prepared to agree that Taxpayer was not responsible for the sales tax concerning C3. Taxpayer however remains liable for the sales tax regarding C1 and C2 because those exemption certificates were issued in 2015—months after the transactions and the audit were concluded.

Taxpayer is reminded that sales tax becomes due at the time of the transaction; either the purchaser is exempt at the time of the transaction or it is not exempt. If the purchaser claims an exemption, the exemption certificate should be obtained at the time the transaction occurs otherwise the burden of proving the transaction was exempt becomes measurably more difficult.

B. Imposition of Use Tax

The Department's audit found that Taxpayer purchased tangible personal property to be used for its business activities in Indiana without paying sales tax or use tax. The audit further determined that those purchases were not exempt from sales/use tax. As a result, the audit assessed additional use tax pursuant to the projection agreement.

Taxpayer, to the contrary, claimed that the assessment of use tax was overstated. Specifically, Taxpayer stated that one of the selected transactions (Reference 17638, in the amount of \$5,243) was not subject to additional use tax because the tax was previously remitted by its utility supplier under the Department's direct pay permit

program. Taxpayer further provided additional documents to support its protest. Thus, Taxpayer maintained that the audit erroneously assessed use tax on one of the selected transactions and the assessment was overstated.

Upon review, the Department's Enforcement Division is requested to review and verify in a supplemental audit the supporting documentation submitted. To the extent that the supplemental audit removes that selected transaction (Reference 17638, in the amount of \$5,243) and makes adjustments, Taxpayer's protest is sustained. Otherwise, Taxpayer's protest on this issue is respectfully denied.

In short, Taxpayer's protest is sustained in part and denied in part. Taxpayer is not responsible for the sales tax on transactions concerning C3. However, Taxpayer remains responsible for the tax on transactions with C1 and C2. Taxpayer's protest of the use tax on one selected transaction (Reference 17638, in the amount of \$5,243) is sustained subject to the supplemental audit review and verification. The supplemental audit review will recalculate Taxpayer's tax liability.

FINDING

Taxpayer's protest is sustained in part and denied in part subject to the results of the Department's supplemental audit review.

II. Tax Administration - Negligence Penalty.

DISCUSSION

Taxpayer requested that the Department abate the negligence penalty.

Pursuant to IC § 6-8.1-10-2.1(a), the Department may assess a ten (10) percent negligence penalty if the taxpayer:

- (1) fails to file a return for any of the listed taxes;
- (2) fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment;
- (3) incurs, upon examination by the department, a deficiency that is due to negligence;
- (4) fails to timely remit any tax held in trust for the state; or
- (5) is required to make a payment by electronic funds transfer (as defined in [IC 4-8.1-2-7](#)), overnight courier, or personal delivery and the payment is not received by the department by the due date in funds acceptable to the department[.]

[45 IAC 15-11-2](#)(b) further states:

"Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The Department may waive a negligence penalty as provided in [45 IAC 15-11-2](#)(c), as follows:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;

(5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

In this instance, during the hearing, Taxpayer offered various reasons to support its request that the Department abate the negligence penalty. Specifically, in addition to its overall good compliance history, Taxpayer documented that, during the audit when the issue of exemption certificates first surfaced, it promptly contacted those customers who claimed their purchases were exempt. Taxpayer further obtained valid exemption certificates from those customers or informed its customers the tax consequences. Taxpayer's documentation also demonstrated that it has implemented a new procedure to address those issues going forward. The Department thus agrees that Taxpayer provided sufficient documentation to demonstrate that the negligence penalty should be abated. Since Taxpayer paid the penalty under protest, the payment will be refunded.

FINDING

Taxpayer's protest of the imposition of negligence penalty is sustained.

SUMMARY

Taxpayer's protest of the imposition of additional sales tax and use tax is sustained in part and denied in part subject to a supplemental audit review and verification. Taxpayer's protest of the imposition of negligence penalty is sustained.

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